IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE:	§	
	§	
KENNETH B. & CARLA NEWELL,	§	
Debtors.	§	CASE NO. 491-40112-DML-7
	§	

IN RE:	§	
	§	
DAVID & DELANE NEWELL,	§	
Debtors.	§	CASE NO. 491-40113-DML-7
	§	

KENNETH B. NEWELL,	§	
CARLA NEWELL, DAVID NEWELL,	§	
and DELANE NEWELL,	§	
Plaintiffs,	§	
	§	
vs.	§	ADV. NO. 02-4284
	§	
STATE OF TEXAS	§	
(TEXAS COMPTROLLER)	§	
Defendant.	§	

KENNETH B. NEWELL,	§	
CARLA NEWELL, DAVID NEWELL,	§	
and DELANE NEWELL,	§	
Plaintiffs,	§	
	§	
vs.	§	ADV. NO. 02-4290
	§	
STATE OF TEXAS	§	
(TEXAS COMPTROLLER)	§	
Defendant.	§	

MEMORANDUM OPINION AND ORDER

Before the court is the Texas Comptroller's Motion to Dismiss Adversary Proceeding (the "Motion") filed by the State of Texas on behalf of the Comptroller (the "State") in each of the above-styled adversary proceedings.[1] The Plaintiffs in the adversary proceedings (also referred to as "Debtors" or, with respect to David and Kenneth Newell, the "Newells") filed Plaintiffs' Response to Motion to Dismiss (the "Response"), in which they cite authorities in support of their position. The State has also filed a memorandum of law (the "Memorandum") providing the court with cases supporting its position. The court heard oral argument on the motion on February 4, 2003. The court's exercise of its jurisdiction is predicated upon 28 U.S.C. §§ 1334(a) and 157(b)(2)(I).

I. Background

The Newells were general partners of Newell & Newell, Ltd., a Texas limited partnership (the "Partnership") which, prior to 1991, served as general contractor for a residential project known as River Bend Estates. In connection with construction of the project, sales taxes were sometimes incurred which were regularly paid by the developer when it paid the Partnership. Unfortunately, the developer's lender became insolvent and the developer ultimately became unable to satisfy amounts due to the Partnership and certain unpaid sales taxes.

In part because of the River Bend fiasco, the Newells were forced in 1991 to file for relief under chapter 11 of the Bankruptcy Code (the "Code"). Shortly thereafter the case was converted to chapter 7. The State filed a claim for taxes in 1991. In 1992 Debtors were discharged. The

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1 Because the adversary proceedings and each of the underlying cases are identical for all practical purposes, the court will from time to time refer to pleadings, cases and adversary proceedings in the singular.

orders discharging Debtors provided in pertinent part:

> "1. The debtor is released from all personal liability for debts existing on the date of commencement of this case . . .
>
> "2. Any . . . judgment which may be obtained in any court with respect to debts described in paragraph 1 is null and void as a determination of personal liability of the debtor, except:
> . . .
>
> b. Debts which are non-dischargeable pursuant to § 523(a)(1) . . . of the Bankruptcy Code."

Debtors' bankruptcy cases were eventually closed. Prior to their closing, no objection was made to the State's claims[2] nor was any action initiated by the State or the Newells to determine whether the debt represented by the State's claims was dischargeable.

In 2000 the State filed suit in the 261st Judicial District Court for Travis County, Texas, against the Partnership and the Newells seeking recovery of sales taxes collected but not paid. The Newells responded to the State's complaint by general denial and urged various affirmative defenses, including their discharges in bankruptcy. The State thereafter sought summary judgment on its complaint, citing a certificate of liability issued by the Texas Comptroller as proof of the Partnership's liability for the claimed sales tax and, by extension, that of the Newells as general partners. Through the failure of the Newells' counsel, the Newells failed to appear a the hearing on the State's motion for summary judgment. As a result, on April 16, 2001, the state district court entered its Final Summary Judgment (the "Judgment"). The Judgment states,

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[2] The recitation of facts provided is largely taken from the Response. The Response did not mention any objection to the State's claim, and the Motion and Memorandum assert there was no objection. The court makes no findings of fact herein, rather testing the Motion against the facts as stated by Plaintiffs. 2 MOORE'S FEDERAL PRACTICE §12.34[1][b] (3rd ed. 2002).

inter alia, that the State is "entitled to Judgment as prayed for and supported by the evidence as a matter of law." The Judgment further provides that the State "have and recover from [the Partnership and the Newells], the sum of $249,333.31, being the amount of state sales tax, penalties and interest due . . .." Further decretal paragraphs provide for recovery from the Newells of taxes due to the city of Fort Worth, the city of Euless and the Transit Authority of Fort Worth.[3]

The Judgment was not appealed, nor were the Newells able to obtain other redress in state court. However, on September 6, 2002, Debtors filed a motion pursuant to Code section 350 to reopen their bankruptcy cases in order to litigate the dischargeability of the debt represented by the Judgment. The court granted the motion to reopen the bankruptcy cases. *See* FED. R. BANKR. P. 4007(b); 3 COLLIER ON BANKRUPTCY ¶ 350.03[4] (15th ed. rev. 2003). Plaintiffs then commenced these adversary proceedings.

II. Issue

By the Motion, the State asks that the court dismiss this adversary proceeding on the basis of the Rooker-Feldman Doctrine,[4] collateral estoppel or res judicata. In short, the State urges that entry by the state district court of the Judgment precludes this court from now considering whether the underlying debt is dischargeable. Plaintiffs, however, argue that the Judgment does not address the issue of dischargeability and this court is therefore free – and the proper forum – to determine whether the Newells' discharge extended to the debts underlying the Judgment.

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[3] The Judgment also provided for recovery of attorneys' fees by the State.

[4] Rooker v. Fidelity Trust Co., 263 U.S 413, 44 S Ct. 149 (1923); Dist. of Columbia Court of Appeals v Feldman, 460 U S. 462, 103 S. Ct. 1303.

The task now facing the court is thus limited to deciding if the Judgment eliminates this court's authority to consider whether, on the merits of the case, the debt represented by the Judgment is excepted from discharge under section 523(a)(1) of the Code.[5]

III. Discussion

This Motion properly raises the issue of whether the Judgment precludes this court from now determining the merits of the dischargeability, as to Debtors, of the underlying debt. *See* 2 MOORE'S FEDERAL PRACTICE §12.34[4][b] (3rd ed. 2002). However, the case at bar does not require the analysis ordinarily applied to determine whether or not a prior proceeding is dispositive of an issue so as to bind a forum addressing the same or a similar matter later.

The cases cited to the court uniformly involve the question of whether, in a subsequent bankruptcy, the bankruptcy court is bound to accept for purposes of determining dischargeability of a debt findings reflected in a judgment obtained prepetition by a creditor. *See Brown v. Felsen*, 442 U.S. 127, 128-29, 99 S. Ct. 2205, 2208 (1979); *Grogan v. Garner*, 498 U.S. 279, 281, 111 S. Ct. 654, 656 (1991); *Matter of Pancake*, 106 F.3d 1242, 1243-44 (5th Cir. 1997); *Matter of Miller*, 156 F.3d 598, 601 (5th Cir. 1998); *Matter of King*, 103 F.3d 17, 18 (5th Cir. 1997); *In re Meece*, 261, B.R. 403 (Bankr. N.D. Tex. 2001).

The instant case does not present such a situation. In the cases cited by the parties, the nature of the objection to dischargeability required that it be litigated in the bankruptcy court

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[5] Section 523(a)(1) states. "(a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt – (1) for a tax or customs duty – (A) of the kind specified in section . . . 507(a)(8) of this title whether or not a claim for such tax was filed or allowed . . .." Section 507(a)(8)(C) describes "a tax required to be collected or withheld and for which the debtor is liable in any capacity."

during the bankruptcy case pursuant to section 523(c)(1) of the Code (or its predecessor, §17C(2) of the former Bankruptcy Act).

Claims such as that of the State[6], if valid at all, pass through a bankruptcy case unscathed. *See, e.g., In re Mendiola*, 99 B.R. 864, 867 (Bankr. N.D. Ill. 1989). On their respective faces, neither the applicable sections of the Code nor the order discharging the Newells purported to affect claims for taxes such as those asserted by the State. It is true that the Newells (or the State) could have joined issue during Debtors' bankruptcy in this court on the merits of whether the State had a nondischargeable tax claim. Likewise, prior to the closing of their cases, the Newells could have challenged the merits of the State's claim through a claim objection.[7]

Since no such litigation was initiated, the State's claim against the Newells survived their bankruptcy case. The Newells might arguably have reopened their cases to address dischargeability of the State's claim before the State commenced litigation in state district court.[8] But once the State asserted its claims in that court, it was too late for the Newells to bring the matter before this court. This is so for several reasons.

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6 The State relies on section 507(a)(8)(C) of the Code (though during argument the State suggested section 507(a)(8)(E) might also be applicable to some of the debt) No claim falling within the description of section 507(a)(8)(C) is dischargeable since, unlike, e.g., section 507(a)(8)(A), section 507(a)(8)(C) contains no time limits that could run, so effecting discharge of the tax claim. See section 523(a)(1)(A) of the Code.

7 The court does not have before it enough facts to determine whether Debtors' bankruptcy cases were asset cases If they were, and if the State received partial payment on its claim as a tax claim, the court questions how it could *now* address the issue of dischargeability which, after all, is no more than the question of liability. Allowance of and payment against the State's claim during the bankruptcy case would at least raise a question of laches – if not issue preclusion.

8 Typically cases are reopened to discharge debt not recognized in the case prior to its first closing. *See, e.g In re* Hicks, 184 B R 954 (Bankr. C D Cal. 1995) As discussed in note 7 the court is by no means certain it would be proper to reopen a case to litigate the issue of dischargeability of an allowed claim which issue should have been evident to Debtors before the case was initially closed, indeed more than ten years ago.

First, as noted above, the State's claim was the sort that would automatically pass through a bankruptcy case as an ongoing obligation of Debtors. The mere fact of the Newells' liability is determinative of the claim's nondischargeability. If the Newells *owe* the State for taxes which were "required to be collected or withheld and for which the debtor is liable in whatever capacity" (Code, § 507(a)(8)(C)), that debt is not dischargeable according to the plain meaning of section 523(a)(1)(A) of the Code. This court is bound to interpret the statute according to its plain meaning. *See, e.g., Toibb v. Radloff*, 501 U.S. 157, 162, 111 S. Ct. 2197, 2200 (1991).

Second, a state court has concurrent jurisdiction with the bankruptcy court to determine the dischargeability of the debt other than as specified in section 523(c)(1). Because the State in its suit sought to establish the Newells' liability, and because a determination of their liability for sales taxes is tantamount to a determination of nondischargeability, mere commencement of the suit in state court would prevent this court (absent removal) from assuming jurisdiction over the question of discharge.

Third, the Newells pleaded their discharge in the state court suit. They had the opportunity to argue liability there – or any other discharge theory they might devise. They have had their day in court. This court is sympathetic to the Newells' plight. That they were let down by their counsel (not their lawyer before this court) is a tragic commentary on the legal profession and the laxity of the bar and its supervisory authorities in monitoring the quality and qualifications of those seeking entry into the legal profession and continued licensing. If this court were deciding the question of whether the Newells should have a second day in state court,

it might well answer in the affirmative. The Newells raise serious questions as to whether they really were liable for the taxes underlying the Judgment.

But this court cannot review the conduct of the state court, and that is what Plaintiffs ask it to do. *See Matter of Reitnauer*, 152 F.3d 341 (5th Cir. 1998). The state court, having before it the issue of the Newells' liability, automatically had to determine whether the State's claim fell within section 507(a)(8)(C) of the Code. The state court's decision that the Newells have liability amounts to a determination of nondischargeability under section 523(a)(1)(A) of the Code. For this court to enter the fray now would risk inconsistent rulings -- for this court could not determine the discharge issue in Plaintiffs' favor without contradicting the state court's prior determination of liability.

IV. Conclusion and Order

For the reasons stated above, the Motion must be GRANTED. It is, therefore,

ORDERED, ADJUDGED and DECREED that this adversary proceeding be, and it hereby is, DISMISSED, and it is further

ORDERED that each party shall bear its own costs; and its is further

ORDERED that the Clerk of this court close these chapter 7 cases, their administration being complete.

SIGNED this the 13th day of February 2003.

DENNIS MICHAEL LYNN
UNITED STATES BANKRUPTCY JUDGE